

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-02 INR-07 L-03

NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

AID-05 COME-00 EB-07 FRB-03 TRSE-00 XMB-02 OPIC-03

CIEP-01 LAB-04 SIL-01 OMB-01 FEA-01 ERDA-05 CEA-01

FPC-01 INT-05 SAM-01 OES-06 STR-04 ACDA-07 /115 W

----- 121976

R 032202Z DEC 76

FM AMEMBASSY CARACAS

TO SECSTATE WASHDC 5878

C O N F I D E N T I A L SECTION 1 OF 2 CARACAS 14188

E.O. 11652: GDS

TAGS: EFIN, EGEN, VE

SUBJECT: VENEZUELA'S FISCAL CORNUCOPIA-IS IT EXHAUSTED?

1. SUMMARY: THE EASY YEARS OF VENEZUELA'S FISCAL ABUNDANCE ARE ENDING-A SITUATION INCREASINGLY RECOGNIZED BY BOTH FRIENDS AND OPPONENTS OF THE GOV. VENEZUELA IS NOT ABOUT TO ENTER AN ERA OF GOVERNMENT AUSTERITY, BUT WE CAN ANTICIPATE INCREASING DOMESTIC CONTROVERSY, AS THE GOV TRIES TO TAP ADDITIONAL DOMESTIC SOURCES OF REVENUE, AND A MORE MILITANT ATTITUDE ON OIL PRICES. END SUMMARY.

2. IN ITS EDITION OF NOVEMBER 21 VENEZUELA'S WEEKLY MAGAZINE RESUMEN OBSERVED EDITORIALY THAT WHAT ONCE SEEMED IMPOSSIBLE NOW APPEARS PROBABLY-VENEZUELA'S "HORN OF PLENTY" IS BEING EXCHANGED FOR "PANDORA'S BOX". "PANDORA'S BOX", ACCORDING TO RESUMEN, IS THE GOV'S RECENTLY REVEALED PROJECT FOR TAX REFORM. RESUMEN GOES ON TO CITE COPEI SENATOR GODOFREDO GONZALEZ'S RECENT OBSERVATION THAT FOR THE FIRST TIME IN MANY YEARS CURRENT EXPENDITURES PLUS PUBLIC DEBT

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SERVICE IN 1977 WILL EXCEED THE GOV'S REVENUES FROM THE

PETROLEUM INDUSTRY.

3. VENEZUELA'S FISCAL CORNUCOPIA IS NOT YET EXHAUSTED. PETROLEUM REVENUES, THOUGH LOWER THAN THEIR PEAK OF \$9.2 BILLION IN 1974, WILL STILL AMOUNT TO A VERY RESPECTABLE \$6.1 BILLION IN 1977, ACCORDING TO THE CONSERVATIVE ESTIMATE IN THE 1977 BUDGET PROJECT (NOT YET APPROVED BY THE CONGRESS). THIS IS MORE THAN THREE TIMES THE \$2 BILLION COLLECTED IN 1972 FROM THE OIL INDUSTRY. THE GOV ALSO HAS A \$5 BILLION "KITTY" IN THE VENEZUELAN INVESTMENT FUND, ACCUMULATED FROM LARGE FISCAL SURPLUSES IN 1974 AND 1975. NEVERTHELESS, SENATOR GONZALEZ PUT HIS FINGER ON THE WEAKEST LINK IN THE GOV'S FISCAL CHAIN. CURRENT EXPENDITURES SOARED FROM \$1.9 BILLION IN 1972 TO AN ESTIMATED \$5.0 BILLION IN 1977. IF THE BUDGET IS APPROVED WITHOUT SIGNIFICANT AMENDMENT (AS PRESUMABLY IT WILL BE), CURRENT EXPENDITURES WILL CONSTITUTE 60 PERCENT OF ALL EXPENDITURES, VERSUS 54 PERCENT IN 1976.

4. A MAJOR PORTION OF THE INCREASE IN CURRENT EXPENDITURES BUDGETED HAS BEEN ALLOCATED TO PUBLIC SERVICES-ESPECIALLY EDUCATION AND HEALTH. INCREASED SPENDING ON ESSENTIAL SOCIAL SERVICES HAS THE COMMENDABLE OBJECTIVE OF SPREADING THE BENEFITS OF THE GOV'S PETROLEUM BONANZA. NEVERTHELESS, IT HAS LOCKED THE GOV INTO AN INFLEXIBLE HIGHER LEVEL OF SPENDING WHICH WILL BE IMPOSSIBLE TO REDUCE AND DIFFICULT TO MODERATE, ESPECIALLY AS THE 1978 ELECTIONS APPROACH. MOREOVER, THE INCREASE IN CURRENT SPENDING COMES AT A TIME WHEN THE GOV IS EMBARKING ON A FIVE-YEAR \$27 BILLION PUBLIC INVESTMENT PROGRAM (PLAN V).

5. PRESSURE ON FISCAL RESOURCES IS ALREADY PRODUCING IMPORTANT CHANGES IN GOV POLICIES. SEVERAL MONTHS AGO THE GOV RECEIVED AUTHORITY FROM CONGRESS TO BORROW MORE THAN \$4 BILLION EXTERNALLY AND DOMESTICALLY TO FINANCE DEVELOPMENT PROJECTS (NOT INCLUDING \$1 BILLION RECENTLY CONTRACTED ABROAD TO REFINANCE

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SHORT-TERM LOANS). THE DECISION TO BORROW WAS MADE OVER THE PROTEST OF THE THEN VICE MINISTER OF FINANCE, IVAN PULIDO, WHO RESIGNED IN PROTEST AND HAS SINCE BECOME A STRONG PUBLIC CRITIC OF GOV FISCAL POLICIES. PULIDO ARGUES THAT INSTEAD OF RELYING ON A MASSIVE FOREIGN CREDIT PROGRAM TO FINANCE ITS DEVELOPMENT PROGRAM, THE GOV SHOULD RELY ON DOMESTIC SOURCES-PARTICULARLY INCREASED REVENUES

THROUGH TAX REFORM. THE GOV'S CREDIT PROGRAM WAS APPROVED BY THE CONGRESS OVER THE STRONG OPPOSITION OF COPEI, WHICH CASTIGATED THE "WASTEFUL" PRACTICES OF THE PEREZ ADMINISTRATION IN ALLOWING EXPENDITURES TO GET OUT OF HAND.

6. "PANDORA'S BOX"-THE ADMINISTRATION'S TAX REFORM PACKAGE-HAS STIRRED UP THE GREATEST WAVE OF BUSINESS SECTOR PROTEST YET FACED BY PRESIDENT PEREZ. THE PACKAGE OF EIGHT DRAFT TAX BILLS WAS REVEALED SEVERAL WEEKS AGO AND CAREFULLY DESCRIBED BY THE GOV AS DESIGNED TO REFORM THE FISCAL SYSTEM RATHER THAN TO RAISE ADDITIONAL REVENUES. ONLY A FEW DAYS PASSED, HOWEVER, BEFORE THE ECONOMIC ESTABLISHMENT CRIED "FOUL" AND AN AVALANCHE OF PROTEST BROKE LOOSE. THE PRIVATE BUSINESS SECTOR CONCLUDED THAT IT WOULD BE SADDLED WITH A SUBSTANTIAL TAX INCREASE IF THE MEASURES WENT UNCONTESTED. ONE PRELIMINARY PRIVATE ESTIMATE INDICATES THAT THE TAX MEASURES WOULD DOUBLE THE \$2 BILLION ANNUAL TAX TAKE FROM THE NON-EXPORT SECTOR OF THE ECONOMY. FEDECAMARAS PRESIDENT ANTONIO DIAZ MARTINEZ, PREVIOUSLY A CONSISTENT SUPPORTER OF THE PEREZ ADMINISTRATION, SOON BECAME THE PRINCIPAL LEADER OF A CAMPAIGN TO PERSUADE THE GOVERNMENT TO WITHDRAW THE DRAFT BILLS OR AT LEAST AMEND THEM SUBSTANTIALLY. EUGENIO MENDOZA, SEMI-RETIRED DOYEN OF THE PRIVATE SECTOR, CELEBRATED HIS 70TH BIRTHDAY WITH A VIGOROUS PROTEST AGAINST THE TAX PACKAGE. TAX REFORM IS CERTAIN TO BE VENEZUELA'S MOST CONTROVERSIAL DOMESTIC POLITICAL ISSUE AS CONGRESS CONSIDERS THE DRAFT BILLS IN THE MONTHS AHEAD.

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NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

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CIEP-01 LAB-04 SIL-01 OMB-01 FEA-01 ERDA-05 CEA-01

FPC-01 INT-05 SAM-01 OES-06 STR-04 ACDA-07 EUR-12

/127 W

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R 032202Z DEC 76

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C O N F I D E N T I A L SECTION 2 OF 2 CARACAS 14188

7. VENEZUELA'S UNDER-TAXED DOMESTIC PRIVATE SECTOR HAS SUCCESSFULLY RESISTED PREVIOUS GOVERNMENT ATTEMPTS TO LADEN IT WITH ANY SUBSTANTIAL TAX BURDEN. IT HAS HERETOFORE BEEN POLITICALLY EXPEDIENT FOR THE GOV TO AVOID A CONFRONTATION WITH THE PRIVATE SECTOR BY TURNING REPEATEDLY TO THE FOREIGN-OWNED PETROLEUM SECTOR WHEN GOVERNMENT COFFERS NEEDED FILLING. WHEN THIS EXPEDIENT WAS VIRTUALLY EXHAUSTED, VENEZUELA HAD THE GOOD FORTUNE OF SEEING ITS COFFERS FILLED TO OVERFLOWING BY THE QUADRUPLING OF PETROLEUM PRICES IN 1973.

8. VENEZUELA IS NO LONGER HAS THE OPTION OF SATISFYING ITS VORACIOUS APPETITE FOR INCREASED REVENUES THROUGH THE POLITICALLY POPULAR TECHNIQUE OF SQUEEZING THE PROFITS OF A FOREIGN-OWNED PETROLEUM INDUSTRY. IN FACT, THE TAX BURDEN ON THE NATIONALIZED INDUSTRY WAS REDUCED EARLIER THIS YEAR IN ORDER TO ELIMINATE THE BOOKKEEPING LOSS MOST OF THE OPERATING COMPANIES HAD REGISTERED AS A RESULT OF THE REQUIREMENT THAT THEY

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CONTRIBUTE TEN PERCENT OF NET PROFITS TO PETROVEN FOR INVESTMENT FUNDING.

9. EVEN THE OPTION OF INCREASING PETROLEUM PRODUCTION IS LIMITED. IN THE FIRST PLACE, IT WOULD CONTRAVENE VENEZUELA'S OIL CONSERVATION POLICY. MORE IMPORTANTLY, CURRENT CAPACITY IS NO MORE THAN 2.6 MILLION BARRELS PER DAY-NOT SIGNIFICANTLY HIGHER THAN CURRENT PRODUCTION OF 2.3 MILLION BARRELS PER DAY. LARGE INVESTMENTS WILL BE REQUIRED OVER THE NEXT FEW YEARS JUST TO MAINTAIN CURRENT PRODUCTION CAPACITY.

10. THE PEREZ ADMINISTRATION WILL BE UNDER INCREASING PRESSURE TO CONTINUE TO EXPAND SOCIALLY-ORIENTED PROGRAMS DURING ITS REMAINING TWO YEARS. SOME LARGE PUBLIC INVESTMENT PROGRAMS MAY BE POSTPONED (E.G., RAILROADS, SHIPYARDS, AVIATION INDUSTRY, ZULIA STEEL

MILL), BUT MOST PUBLIC INVESTMENTS ARE NOW FIRMLY COMMITTED AND WILL PROCEED AS PLANNED.

11. HOW WILL THE GOV FINANCE ITS INCREASING REVENUE NEEDS IN THE FACE OF A STATIC OR DECLINING PETROLEUM INDUSTRY? THE MOST ADVISABLE ECONOMIC POLICY WOULD APPEAR TO BE INCREASED TAXATION OF AND BORROWING FROM THE INTERNAL ECONOMIC SECTOR. THIS CHOICE WOULD COUNTER INFLATIONARY PRESSURES WHICH ARE BOUND TO ACCOMPANY ANY SIGNIFICANT EXPANSION IN PUBLIC SPENDING AND WOULD TEND TO REDUCE VENEZUELA'S IMPENDING BALANCE OF PAYMENTS DEFICIT BY REDUCING IMPORTS. A POLITICAL PRICE MAY BE PAID, HOWEVER, IF THE GOVERNMENT RAMS THROUGH A LARGE TAX INCREASE. IT IS NOT YET CLEAR WHETHER ACCION DEMOCRATICA IS DETERMINED TO RUN THIS RISK WITH ELECTIONS APPROACHING. AD IS NOT LIKELY TO BACK DOWN COMPLETELY ON TAX REFORM, BUT IT MAY PERMIT THE TAX BILLS TO BE EMASCULATED IN CONGRESSIONAL COMMITTEE. ADDITIONAL FOREIGN BORROWING BEYOND THAT NOW PLANNED IS POSSIBLE, BUT THAT ALSO WOULD RISK POLITICAL REPERCUSSIONS AND WOULD NOT BE A WISE ECONOMIC POLICY CHOICE.

12. THERE IS NO EASY SOLUTION TO THE GOV'S DILEMMA.
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ONE CONSEQUENCE MAY BE A MORE MILITANT ATTITUDE TOWARDS PETROLEUM PRICE INCREASES. AT THE VERY LEAST, VENEZUELA WILL NOT BE RECEPTIVE TO APPEALS BY U.S. OR OTHER INDUSTRIALIZED NATIONS TO HOLD DOWN OIL PRICES. VENEZUELA WILL NOT PERCEIVE ITSELF AS A NATION WITH PETROLEUM REVENUES TO SPARE.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, PETROLEUM INDUSTRY, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 03 DEC 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: ShawDG
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976CARACA14188
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D760449-0703
From: CARACAS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19761272/aaaackdd.tel
Line Count: 260
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION ARA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: ShawDG
Review Comment: n/a
Review Content Flags:
Review Date: 21 JUL 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <21 JUL 2004 by ElyME>; APPROVED <21 JUL 2004 by ShawDG>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: VENEZUELA'S FISCAL CORNUCOPIA-IS IT EXHAUSTED?
TAGS: EFIN, EGEN, VE
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006